

Message Text

UNCLASSIFIED

PAGE 01 STATE 136352
ORIGIN DLOS-09

INFO OCT-01 ISO-00 /010 R

DRAFTED BY D/LOS:FSMHODSOLL/AD
APPROVED BY D/LOS:FSMHODSOLL
-----140212Z 055804 /64-62
R 131954Z JUN 77
FM SECSTATE WASHDC
TO CONRAD WELLING TELEX NO. 34-6409 -

UNCLAS STATE 136352

E.O. 11652: N/A

TAGS: LOS

SUBJECT: APPENDIX A: QUANTIFICATION OF DIFFERENCES IN
TAX TREATMENT OF OCEAN MINING VENTURES

1. FROM THE POINT OF VIEW OF A US VENTURER, WE MAY COMPUTE THE VALUE OF "DOMESTIC" TAX TREATMENT AS AN AMOUNT THE VENTURER WOULD BE WILLING TO PAY FOR THAT TREATMENT RATHER THAN "FOREIGN." IT IS ALSO AN AMOUNT AVAILABLE TO HIM TO PAY FOR A "LICENSE" TO MINE, EITHER AS A "BONUS" OR "ROYALTY" PER TON OF MATERIAL REMOVED.

2. TO MAKE SUCH CALCULATIONS, SOME SPECIFICATION OF EXPENDITURES RELATED TO THE MINING, TRANSPORTATION, AND PROCESSING IS REQUIRED. FOR THIS PURPOSE, WE RELY ON A PUBLICATION OF THE OCEAN MINING ADMINISTRATION OF THE DEPARTMENT OF THE INTERIOR WHICH SUMMARIZES THE FRAGMENTARY INFORMATION ON THIS AS YET SPECULATIVE ACTIVITY.(1) BASED ON THE PUBLISHED "MEDIUM" COST ESTIMATES FOR A VENTURE WHICH WOULD SUPPLY 3 MILLION TONS OF NODULES PER YEAR TO BE PROCESSED INTO NICKEL, COPPER, AND COBALT,(2) AND ADDING THE COST OF AN ALTERNATIVE SITE TO BE PROVIDED GRATIS TO THE DSA AS IS PRESENT-
UNCLASSIFIED

UNCLASSIFIED

PAGE 02 STATE 136352

TLY CONTEMPLATED, WE COMPUTED THE PRESENT VALUE OF THE MINIMUM GROSS INCOME FROM THE SALE OF THE AFOREMENTIONED METALS WHICH WOULD BE REQUIRED TO YIELD THE VENTURER A 15

PERCENT RATE OF RETURN AFTER TAXES UNDER TWO REGIMES: 1. THE ENTIRE PROJECT IS REGARDED AS "DOMESTIC"; 2. THE SEA-BASED MINING ACTIVITY IS "FOREIGN". (3)

3. IF THE ENTIRE PROJECT IS TREATED AS DOMESTIC, THE PRESENT VALUE OF THE "REQUIRED" TOTAL SALES OVER THE ESTIMATED 20-YEAR PRODUCTIVE LIFE OF THE PROJECT WOULD BE JUST OVER 830 MILLION DOLLARS. OF THIS TOTAL VALUE OF PRODUCT, 35 PERCENT WOULD BE ADDED BY MINING, 9 PERCENT BY TRANSPORTATION, AND 56 PERCENT BY ON-SHORE PROCESSING.(4) IF SALES VALUES OF THE MINERALS FINALLY SOLD, AS PROJECTED BY THE AFOREMENTIONED PUBLICATION, ARE USED AS A REFERENCE POINT, THE VENTURER WOULD BE WILLING TO PAY THE DSA UP TO 16 MILLION DOLLARS (IN ADDITION TO THE AFOREMENTIONED ALTERNATIVE SITE) FOR THE LICENSE TO MINE. ALTERNATIVELY, THE VENTURER WOULD BE WILLING TO PAY 3.85 DOLLARS PER TON OF NODULES REMOVED, WHEN REMOVED. (5)

4. IN CONTRAST, IF THE SEA-MINING OPERATION IS TREATED AS "FOREIGN", THE LOSS OF THE INVESTMENT CREDIT WITH RESPECT TO THAT INVESTMENT, ALONG WITH SOMEWHAT SLOWER DEPRECIATION AND A PERCENTAGE DEPLETION RATE OF ONLY 14 PERCENT RATHER THAN THE WEIGHTED AVERAGE 19 PERCENT FOR "DOMESTIC" MINING OF THE SAME MINERALS, INCREASES THE "REQUIRED" TOTAL SALES TO 855 MILLION DOLLARS, WHICH IS 25 MILLION DOLLARS MORE THAN UNDER "DOMESTIC" TAX TREATMENT. GIVEN THE SAME PROJECTED MINERAL PRICES, THE VENTURER COULD ONLY PAY UP TO 3 MILLION DOLLARS FOR THE LICENSE, OR A ROYALTY OF ONLY ABOUT 75 CENTS PER TON OF NODULES, WHEN REMOVED. WHILE THE OVERALL DIFFERENCE BETWEEN "DOMESTIC" AND "FOREIGN" TREATMENT IS NOT LARGE--A MERE 3 PERCENT INCREASE IN "REQUIRED" GROSS SALES INCOME--IT IS AN 80 PERCENT REDUCTION IN THE UNCLASSIFIED

UNCLASSIFIED

PAGE 03 STATE 136352

VENTURER'S MAXIMUM BIDDABLE BONUS OR ROYALTY, UNDER THE ASSUMED CONDITIONS OF THIS EXAMPLE. THIS MUST ALWAYS BE TRUE, BECAUSE THE RENTAL VALUE OF THE SEA-BED WILL ALWAYS BE A TINY FRACTION OF THE TOTAL VALUE OF MINERAL PRODUCT. (6)

5. THESE CALCULATIONS MAY BE SUMMARIZED AS FOLLOWS:

MAXIMUM DSA "TAKE"# EXPRESSED AS:

"BONUS" : "ROYALTY"

16 MILLION DOLS 3.85 DOLS PER TON COMPLETELY "DOMESTIC"

3 0.75 "FOREIGN" (AT SEA)

#ASSUMES THE WRIGHT PROJECTIONS OF NICKEL, COPPER, AND COBALT PRICES AND PROJECTS COSTS, ALLOW A 15 PERCENT AFTER-TAX RATE OF RETURN TO THE VENTURER.

FOOTNOTES:

(1) REBECCA L. WRIGHT, OCEAN MINING: AN ECONOMIC EVALUATION; MAY, 1976.

(2) ACCORDING TO WRIGHT, TECHNOLOGY FOR THE EXTRACTION OF MANGANESE IN USEFUL FORM IS STILL NOT WELL-ENOUGH DEFINED TO PERMIT COST SPECIFICATIONS OF THE ON-SHORE PROCESSING. MOREOVER, SHE CONSIDERS THAT MANGANESE PROCESSING MAY FULLY BE CONSIDERED AS PROCESSING "TAILINGS" OF THE NICKEL-COPPER-COBALT PROCESS. IBID, APPENDIX A.

(3) THE PUBLISHED DATA WERE ORGANIZED SIMPLY TO PERMIT COMPUTATION OF AN INTERNAL RATE OF RETURN. FOR OUR PURPOSES, AND TO FACILITATE REASONABLY ACCURATE REPRESENTATION OF THE CRITICAL TAX TERMS, IT WAS NECESSARY TO REORGANIZE THE BASIC INFORMATION. MISS BARBARA LLOYD, WHO HAD PERFORMED THE ORIGINAL COMPUTATIONS KINDLY PROVIDED US UNCLASSIFIED

UNCLASSIFIED

PAGE 04 STATE 136352

WITH DISAGGREGATION OF INVESTMENT AND OPERATING COSTS, BY SITE. FORTUNATELY, THE COST SPECIFICATIONS TREAT TRANSPORTATION AS INDEPENDENTLY PROVIDED, NOT AS AN INTEGRATED OPERATION OF THE VENTURER. THIS IS FITTING, FOR OWNERSHIP AND OPERATION OF THE TRANSPORT VESSELS ARE OF NO CONSEQUENCE TO THE ECONOMICS OF THE PROJECT NOR ITS ALTERNATIVE TAX TREATMENTS.

(4) ADDITION OF MANGANESE PROCESSING WOULD GREATLY INCREASE THE ON-SHORE VALUE ADDED SHARE. NEITHER THE MINING NOR TRANSPORT ACTIVITIES DEPEND ON THE EXTENT OF ON-SHORE PROCESSING OF NODULES.

(5) THE COMPUTATION OF MAXIMUM "BONUS" TAKES INTO ACCOUNT THAT THE PAYMENT WILL BECOME A PART OF THE VENTURER'S "DEPLETION" BASIS WHEREAS THE PAYMENTS OF ROYALTIES WILL SIMPLY BE REDUCTIONS OF GROSS INCOME FOR U.S. TAX PURPOSES AS PRODUCTION OCCURS.

THE READER IS CAUTIONED NOT TO TAKE THE NUMERICAL VALUES IN THE TEXT SERIOUSLY. GIVEN THE INSUBSTANTIAL CHARACTER OF THE COST ESTIMATES, ALONG WITH THE IMPLICIT ASSUMPTIONS ABOUT ULTIMATE MINERAL RECOVERY, THE 15 PERCENT DISCOUNT RATE IS CLEARLY TOO LOW TO BE APPLIED TO AN ESTIMATED INCOME STREAM STRETCHING 26 YEARS INTO THE FUTURE (6-YEARS' START-UP, 20-YEARS' PRODUCTION). HAD THE "HIGH" COST ESTIMATES BEEN USED THE PROJECTED INCOME STREAM WOULD HAVE BEEN INSUFFICIENT TO JUSTIFY MAKING THE COMMITMENT, WITHOUT ANY LEASE BONUS OR ROYALTY, TO YIELD A 15 PERCENT RETURN. THE SOLE PURPOSE OF THE NUMERICAL RESULTS IS TO PROVIDE AN INDICATION OF THE RELATIVE MAGNITUDES.

(6) AT BEST, ESTIMATES OF THE MINERAL CONTENT OF THE
NODULES ARE NOT EXPECTED TO BE MUCH OVER 3 PERCENT FOR
COPPER, NICKEL, AND COBALT, ALL OF WHICH ARE FOUND ASHORE
IN ORES WHICH ARE LESS EXPENSIVELY PROCESSED. CLEARLY,
UNCLASSIFIED

UNCLASSIFIED

PAGE 05 STATE 136352

THE PRICE OF MINERALS WILL TRACE THE MARGINAL COST OF
PRODUCTION, AND THIS WILL INEVITABLY BASICALLY CONSIST IN
THE COST OF EXTRACTION, TRANSPORTATION, AND PROCESSING.
ONLY THE SLIGHT DIFFERENCES IN METAL-CONTENT OF NODULES
AND ORES WILL GIVE RISE TO RENTS FOR THE HIGHER-CONTENT
MINERAL SOURCES, AND THESE RENTS WILL BE SMALL RELATIVE
TO TOTAL VALUE ADDED. VANCE

UNCLASSIFIED

NNN

Message Attributes

Automatic Decaptioning: X
Capture Date: 01-Jan-1994 12:00:00 am
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: POLICIES, SEABED, TAXES, MINING INDUSTRY
Control Number: n/a
Copy: SINGLE
Sent Date: 13-Jun-1977 12:00:00 am
Decaption Date: 01-Jan-1960 12:00:00 am
Decaption Note:
Disposition Action: n/a
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment:
Disposition Date: 01-Jan-1960 12:00:00 am
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1977STATE136352
Document Source: CORE
Document Unique ID: 00
Drafter: FSMHODSOLL/AD
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Expiration:
Film Number: D770211-0316
Format: TEL
From: STATE
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1977/newtext/t19770662/aaaacclx.tel
Line Count: 188
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: d9bfc97d-c288-dd11-92da-001cc4696bcc
Office: ORIGIN DLOS
Original Classification: UNCLASSIFIED
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 4
Previous Channel Indicators: n/a
Previous Classification: n/a
Previous Handling Restrictions: n/a
Reference: n/a
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 22-Oct-2004 12:00:00 am
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 2172711
Secure: OPEN
Status: NATIVE
Subject: APPENDIX A: QUANTIFICATION OF DIFFERENCES IN TAX TREATMENT OF OCEAN MINING VENTURES
TAGS: PLOS, EMIN, EFIN, US, LOS
To: WELLING CONRAD TELEX NO 34-6409
Type: TE
vdkgvwkey: odbc://SAS/SAS.dbo.SAS_Docs/d9bfc97d-c288-dd11-92da-001cc4696bcc
Review Markings:
Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
22 May 2009
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009